STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

WISCONSIN ENERGY CORPORATION, INTEGRYS ENERGY GROUP, INC., PEOPLES ENERGY, LLC, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, ATC MANAGEMENT INC. AND AMERICAN TRANSMISSION COMPANY LLC	)	
Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into agreements with affiliated interests pursuant to Section 7-101, and for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization.	)	Docket No. 14-0496

Rebuttal Testimony of

JOHN J. REED

CEO – Concentric Energy Advisors, Inc.

On Behalf of
Wisconsin Energy Corporation

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I. INTRODUCTION AND PURPOSE

Q. Please state your name, affiliation, and business address.

A. My name is John J. Reed. I am Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric") and CE Capital, Inc. located at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. Have you previously filed testimony in Docket No. 14-0496?

A. Yes, I submitted testimony on behalf of Wisconsin Energy Corporation ("WEC") in support of the application that was filed by WEC and Integrys Energy Group ("Integrys") requesting approval of a proposed reorganization pursuant to Section 7-204 of the Public Utilities Act of Illinois.

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my rebuttal testimony is to respond to certain aspects of the direct testimonies of Mr. Michael McNally and Mr. Eric Lounsberry on behalf of Staff of the Illinois Commerce Commission ("Commission"), and to the direct testimony of Mr. Michael P. Gorman on behalf of the City of Chicago and the Citizens Utility Board ("CUB"). In particular, I will respond to these witnesses' questions regarding whether the proposed reorganization meets the statutory requirements of the Illinois Public Utilities Act Section 7-204(b)(1), *i.e.,* whether the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service, and Section 7-204(b)(7), *i.e.,* whether the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

I also address Mr. McNally's questions about whether the proposed reorganization satisfies the requirements of Section 6-103 (which requires that in any reorganization, the Commission shall authorize the amount of capitalization of a public utility formed by a reorganization, which shall not exceed the fair value of the property involved) and Section 9-230 (which prohibits the Commission from reflecting in rates any incremental risk or increased cost of capital which is the result of a public utility's affiliation with non-utility companies). I will also respond to Mr. Gorman's recommendations that the Commission impose a five-year rate freeze, mandate certain "ring-fencing" requirements and prohibit the recovery of certain transition-related costs as conditions to any Commission approval of the proposed reorganization. Finally, I will respond to Mr. Lounsberry's opinion that WEC failed to conduct a thorough due diligence review of Integrys and its operating subsidiaries, and will clarify my direct testimony as it pertains to The Peoples Gas Light and Coke Company's ("PGL's") Accelerated Main Replacement Program ("AMRP").

Messrs. Leverett and Lauber will discuss in more detail WEC's commitments related to the reorganization and will address the various other conditions that have been proposed.

Q. Please summarize your conclusions and recommendations.

A. Nothing in the testimonies of Messrs. McNally, Lounsberry, or Gorman causes me to change my view that the proposed reorganization (1) meets the statutory requirements in Illinois, (2) satisfies the Commission's standard of review, and (3) should be approved by the Commission.

The proposed reorganization will neither diminish the ability of PGL, or North Shore Gas Company ("North Shore"), (together, "Gas Companies"), to provide adequate, reliable, efficient, safe and least-cost public utility service, nor is it likely to result in any adverse rate impacts on retail customers, which are the statutory requirements questioned by Mr. Lounsberry and Mr. McNally. Mr. McNally has concluded that the proposed reorganization will not significantly impair the Gas Companies' ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure. That, coupled with the enhanced financial strength of WEC Energy Group and its ability to potentially finance capital expenditures through internal financing rather than going to external capital markets, will enhance the Gas Companies' ability to provide safe, adequate, reliable, efficient, least-cost public utility service, and may in fact lead to a reduction in their cost of debt. All of this, taken with (1) the fact that WEC Energy Group will have very little non-utility business operations (the most significant source of incremental risk to the cost of capital), (2) credit rating agency comments that it is unlikely that WEC will be downgraded due to the acquisition, (3) WEC's commitment for a two-year base rate freeze at the Gas Companies after the Transaction closes, and (4) the Commission's ability to address base rates thereafter, more than satisfy the statutory requirements questioned by Messrs. McNally and Lounsberry.

My understanding is that the Commission reviews proposed merger applications of public utilities to ensure that there is "no net harm" to customers as a result of the reorganization. Mr. Gorman's direct testimony seems to suggest that the Commission should hold the proposed reorganization to a different standard of review. Specifically, Mr. Gorman recommends that the Joint Applicants should provide benefits to customers

comparable to the value enhancement created by regulatory mechanisms, such as Rider QIP. While I believe that the proposed Transaction will, in fact, provide certain benefits to Illinois ratepayers, it is not necessary for the Commission to find that customers of PGL or North Shore will be better off as a result of the merger, only that customers of the Gas Companies will not be harmed by the merger. Under the applicable standard of review, I continue to believe that the proposed reorganization meets the statutory requirements in Illinois and is in the public interest.

There is no need to impose a five-year rate freeze on the Gas Companies or the ring fencing requirements proposed by Mr. Gorman in order for this transaction to meet the Commission's standard for approval. In addition, the Commission should allow recovery of transition costs, including severance costs and merger integration costs such as corporate restructuring costs, relocation costs, and accounting and IT-related integration costs, to the extent those transition costs are incurred to achieve savings after the merger is completed. Finally, in my view, the Joint Applicants have completed the customary and appropriate due diligence process for this type of transaction.

I continue to believe that the proposed reorganization will result in long-term benefits for Illinois ratepayers, as well as for shareholders of both WEC and Integrys. As such, I recommend that the Commission approve the reorganization as proposed by the Joint Applicants.

II. RESPONSE TO MR. MCNALLY'S DIRECT TESTIMONY

Q. Please briefly summarize Mr. McNally's testimony and recommendations.

A. Mr. McNally finds that the proposed reorganization will satisfy the requirements of Section 7-204(b)(4), which requires that the proposed reorganization will not significantly impair the Gas Companies' ability to raise necessary capital on reasonable

terms or to maintain a reasonable capital structure. Mr. McNally testifies that it is not clear whether the proposed reorganization will satisfy the requirements of Section 7-204(b)(7), which requires that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. Mr. McNally recommends the imposition of certain reporting requirements to address any concerns the Commission might have regarding compliance with Section 6-103 (which requires that in any reorganization, the Commission shall authorize the amount of capitalization of a public utility formed by a reorganization, which shall not exceed the fair value of the property involved) and Section 9-230 (which prohibits the Commission from reflecting in rates any incremental risk or increased cost of capital which is the result of a public utility's affiliation with non-utility companies).

Q. What is your understanding of Mr. McNally's position that it is not clear whether the proposed reorganization will satisfy the requirements of Section 7-204(b)(7)?

A. Mr. McNally testifies that it is possible for the Gas Companies' cost of capital to increase because of the proposed reorganization.[1] On that basis, he concludes that it is not clear whether the proposed reorganization will satisfy the requirements of Section 7-204(b)(7) and recommends conditions to mitigate the effect on the Gas Companies should WEC be downgraded as a result of the merger.[2]

[1] Direct Testimony of Michael McNally, at 9.

[2] Ibid, at 10-11.

Q. What evidence is there that addresses Mr. McNally's concern that the reorganization may have an adverse rate impact on retail customers?

A. Mr. McNally agrees that the Gas Companies will be able to raise capital on reasonable terms, even if WEC's credit rating was downgraded from A- to a lower investment grade.[3] Further, Mr. McNally quotes a Standard and Poor's ("S&P") report indicating that it is unlikely that WEC's credit rating will be downgraded due to acquisition-related debt because key credit metrics for WEC are not expected to fall below the levels necessary to maintain the current rating.[4]

Importantly, after the proposed reorganization is complete, the combined company (WEC Energy Group) will have virtually no non-utility business operations. The Gas Companies will have the same capitalization after the merger as before. Further, the Joint Applicants have indicated that there will be no cross-subsidization between the regulated operating companies and any non-utility affiliates.

Q, What is your conclusion regarding whether the proposed reorganization is likely to have any adverse rate impacts on retail customers?

A. My conclusion is that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. In fact, the Gas Companies' financial strength and credit metrics may be enhanced because WEC Energy Group's enhanced financial strength may enable the combined company to deploy its internally-generated cash flows to finance the capital investment requirements of PGL and North Shore, especially those relating to the AMRP at PGL. The ability to finance capital expenditures through

[3] Ibid, at 6.

[4] Ibid, at 10.

internal financing rather than going to external capital markets is a distinct advantage created by the reorganization and can be expected to lead to a stronger set of credit metrics. This point will be discussed further in connection with the clarification of my direct testimony requested by Staff witness, Mr. Lounsberry.

Q. Please summarize Mr. McNally's testimony concerning whether the proposed reorganization satisfies the requirements of Section 6-103 and Section 9-230.

A. Mr. McNally expresses concern that a possible downgrade of the Gas Companies' credit ratings could cause an adverse rate impact on retail customers of PGL and North Shore.[5] According to Mr. McNally, in prior merger/acquisition proceedings, the Commission has preemptively addressed concerns regarding Section 9-230, which prohibits the Commission from reflecting in rates any incremental risk or increased cost of capital which is the result of a public utility's affiliation with non-utility companies.[6]

Q. What is your response to Mr. McNally's concern about a possible downgrade of PGL's or North Shore's credit rating?

A. Any incremental risk to the cost of capital comes from non-utility affiliates. In this case, the specific concern is whether additional acquisition-related debt at WEC Energy Group will cause the Credit Rating Agencies to downgrade the credit ratings for WEC, PGL and North Shore. Mr. McNally has acknowledged that S&P is unlikely to downgrade the credit rating of WEC (the parent company) because S&P does not expect WEC's credit metrics to fall below certain levels that support the current rating.[7] As discussed in my

[5] Ibid, at 9-10.

[6] Ibid, at 12.

[7] Ibid, at 10.

direct testimony, Moody's expressed a favorable overall view of the Transaction.[8] In addition, WEC has committed that the Gas Companies will not seek any rate increases for a period of two years after the closing of the Transaction. If the Commission determines that the proposed reorganization has resulted in a higher cost of capital for the Gas Companies, the Commission has the ability to mitigate fully any adverse rate impact on retail customers in future rate proceedings. These facts provide a strong showing that the customers of PGL and North Shore will not face any adverse rate impacts from the merger.

III. RESPONSE TO MR. LOUNSBERRY'S DIRECT TESTIMONY

Q. Please summarize the aspects of Mr. Lounsberry's testimony and recommendations that you address.

A. Mr. Lounsberry testifies that the Joint Applicants have not provided sufficient evidence to satisfy the requirements of Section 7-204(b)(1), which requires the Commission to find that the proposed reorganization will not diminish the utility's ability to provide safe, adequate, reliable, efficient, least-cost public utility service.[9] In addition, Mr. Lounsberry requests clarification of my direct testimony regarding how enhanced access to capital and funding of the AMRP helps to demonstrate that the Joint Applicants have met the requirements of Section 7-204(b)(1).[10] Finally, Mr. Lounsberry testifies that, in his

[8] Direct Testimony of John J. Reed, at 24.

[9] Direct Testimony of Eric Lounsberry, at 3.

[10] Ibid, at 11.

opinion, WEC did not conduct a thorough due diligence review, including a detailed review of operating practices of the Gas Companies or of the AMRP.[11]

Q. Please clarify your direct testimony regarding why WEC's enhanced financial strength and access to capital is also an important consideration for the Commission in evaluating whether the proposed reorganization meets the requirements of Section 7-204(b)(1).

A. In my view, there is a direct connection between the first and fourth statutory requirements under Section 7-204(b). Section 7-204(b)(1) requires the Commission to determine that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Section 7-204(b)(4) requires the Commission to find that the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure. Since the provision of regulated utility service is very capital intensive, enhanced access to capital to finance the capital investment requirements of PGL and North Shore is an important factor that will influence the Gas Companies' ability to continue providing high service quality. Staff witness McNally agrees that the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure.[12] As such, he concludes that the proposed reorganization satisfies the requirements of Section 7-204(b)(4).

[11] Ibid, at 18-24.

[12] Direct Testimony of Michael McNally, at 6.

Further, as discussed in my direct testimony, one benefit of the proposed reorganization for Illinois customers is that WEC Energy Group's enhanced financial strength may enable the combined company to deploy its cash flow to finance the capital spending requirements of PGL and North Shore so that the Gas Companies do not need to seek external financing in capital markets.[13] As discussed in my response to Mr. McNally, the ability to finance capital expenditures internally rather than going to external capital markets is a distinct advantage created by the proposed reorganization. PGL's AMRP is critical to modernizing its gas infrastructure so that PGL can continue providing safe, reliable gas distribution service. For that reason, I believe that WEC's enhanced financial strength is a relevant consideration in evaluating whether the proposed reorganization will not diminish the Gas Companies' ability to continue providing adequate, reliable, efficient, safe, and least cost public utility service.

Q. Do you agree with Mr. Lounsberry that your direct testimony suggests that Integrys is not currently capable, or will not be capable in the future, of financing PGL's AMRP?[14]

A. No, I do not. My testimony is that the proposed reorganization will enhance the ability of WEC Energy Group to compete for capital on reasonable terms with larger utility companies.[15] As consolidation has continued in the utility industry, many small and mid-size utility companies have found it necessary to consider mergers and acquisitions so that they are able to maintain the financial scale and strength required to compete for capital on reasonable terms to finance their ongoing capital investment requirements. As

[13] Direct Testimony of John J. Reed, at 29-30.

[14] Direct Testimony of Eric Lounsberry, at 11.

[15] Direct Testimony of John J. Reed, at 13.

discussed in my direct testimony, one of the primary drivers behind utility industry consolidation is the enhanced financial strength of the combined company. Enhanced financial strength is expected to provide certain benefits, including stronger balance sheets, higher credit ratings, and the ability to more effectively compete with larger entities for debt and equity capital to finance capital investment requirements, all of which will benefit both ratepayers and shareholders.[16]

Further, while I continue to believe that the proposed reorganization will enhance PGL's ability to complete the AMRP in a timely manner relying in part on the internal cash flows of WEC, the Illinois statute only requires the Commission to find that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. There is no statutory requirement that service quality be enhanced by the proposed reorganization, although, in this instance, I believe it will be.

Q. Please summarize Mr. Lounsberry's concern that WEC failed to conduct a thorough due diligence review of Integrys and its operating subsidiaries before announcing the merger.

A. Mr. Lounsberry states that without a thorough due diligence review and report, WEC could not know the risk it is assuming, how much Integrys is worth, or whether the companies are a good fit operationally.[17] Further, Mr. Lounsberry expresses his view that

[16] Direct Testimony of John J. Reed, at 13.

[17] Direct Testimony of Eric Lounsberry, at 20.

WEC should have looked at how the infrastructure replacement needs at PGL could pose risks to investors.[18]

Q. What is your response to Mr. Lounsberry?

A. Let me begin by addressing his concern about whether the two companies are a "good fit" operationally. WEC and Integrys both own gas distribution companies and are experienced with the day-to-day operations of those utilities. In particular, both WEC and Integrys have electric and gas construction experience. Based on my experience, it is reasonable to assume that project management and construction practices across the various operating utilities of WEC and Integrys are not identical, and sharing best practices across the two firms will provide benefits across the operating utilities. There is certainly no downside risk associated with pooling the Joint Applicant's project and construction management experience.

Q. Based on your experience, was the due diligence that was performed by WEC and Integrys consistent with other mergers of this type?

A. Yes, it was. As described in the proxy statement of both companies seeking shareholder approval of the merger, both WEC and Integrys engaged in due diligence for several months before the merger was consummated in June 2014. The due diligence process included sharing non-public financial information and projections, operational data, capital investment plans, and strategic outlooks between management of the two companies, as well as their financial advisors and outside experts. For example, on March 28, 2014, the senior management teams of WEC and Integrys, together with their

[18] Direct Testimony of Eric Lounsberry, at 21.

respective financial advisors, "shared non-public information regarding their respective businesses, including company overviews and information regarding their respective strategic plans and historical performance, upcoming rate cases, labor relations, pending legal matters and debt profiles."[19] In deciding whether to enter into the merger with Integrys, the Wisconsin Energy Board considered "certain risks inherent in Integrys' business and operations, including risks relating to future rates and returns associated with Integrys' business operations and risks associated with Integrys' contingent liabilities. Taking into account input from management and outside advisers regarding the due diligence process, the Wisconsin Energy Board believed that these risks were manageable as part of the ongoing business of the combined company."[20]

I agree with the Joint Applicant's response to AG 4.01, which asked if WEC had requested and reviewed a detailed work plan of PGL's AMRP. In my experience, it is not customary for pre-merger due diligence to include investigation into the specifics of the utilities' "on-the-ground" operations before the Transaction has been approved by the multiple regulatory bodies that must review it. Rather, it is typical and appropriate for this work to be performed once approval for the merger has been received and merger integration activities have begun. Pre-merger due diligence typically involves an assessment of the material condition of the target company, an analysis of whether the financial and economic projections are reasonable, and an evaluation of the business, financial and regulatory risk of the target company.

[19] Wisconsin Energy Corporation, SEC Form S-4, August 13, 2014, at 42.

[20] Ibid, at 54.

Q. Are there any other important considerations in assessing the due diligence that was performed prior to the merger announcement?

A. Yes. WEC and Integrys both are publicly-traded, regulated companies that are subject to extensive reporting and disclosure requirements, including Sarbanes-Oxley. In addition, WEC has committed that the Gas Companies will maintain local headquarters and will continue to have local management. As such, the proposed reorganization will be seamless to customers. WEC Energy Group also has committed that it will be subject to the rules and regulations of the Commission upon approval of the proposed Transaction, including the requirement to provide safe, reliable gas distribution service.

Q. Please summarize your conclusion with respect to the whether WEC and Integrys have satisfied the requirements of Section 7-204(b)(1).

A. In my view, the combination of WEC and Integrys will not diminish service quality, and in fact is likely to enhance the operational ability of the utility operating companies over time through sharing best practices across companies and through the enhanced financial strength and access to capital of the combined company. In any event, while it is the Joint Applicants' intent to strive towards such improvements and their belief is that they will be attainable over time, Section 7-204(b)(1) does not require proof that such improvement will occur immediately, if at all – only that the utilities' existing ability to provide adequate, reliable, efficient, safe and least-cost public utility service will not be diminished as a result of the proposed reorganization.

IV. RESPONSE TO MR. GORMAN'S DIRECT TESTIMONY

Q. Please summarize the aspects of Mr. Gorman's testimony and recommendations that you will address.

A. Mr. Gorman recommends that the Commission impose a five-year rate freeze on PGL and North Shore as a condition of merger approval based on his view that the Gas Companies' risk profile has been reduced by various rider mechanisms, including Rider QIP.[21] In addition, Mr. Gorman recommends that the Joint Applicants should not be allowed to recover certain transition costs, including severance packages for executives and employees and other merger integration costs.[22] Lastly, Mr. Gorman recommends ring fencing requirements based on his concern that acquisition-related debt used to finance the transaction will limit the ability of the Gas Companies to fund their capital spending programs and to ensure safe and reliable gas distribution service.[23]

Q. Please explain Mr. Gorman's basis for recommending a five-year rate freeze as a condition of merger approval.

A. Mr. Gorman testifies that the Gas Companies' risk profile has been reduced by various rider mechanisms. In particular, Mr. Gorman states that Rider QIP is a major element of PGL's premium value to the acquiring firm, WEC.[24] Mr. Gorman testifies that riders shift the risk of cost recovery from Integrys investors to Illinois ratepayers[25], and that this risk reduction enhances the value of Integrys' stock and reduces investor return

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21 Direct Testimony of Michael P. Gorman, at 2.

22 Ibid, at 2.

23 Ibid, at 2-3.

24 Ibid, at 4-5.

25 Ibid, at 5.

requirements.[26] He concludes that a five year rate freeze is appropriate given the significant value of the rider mechanisms and the potential for cost savings.[27]

Q. Do you agree with Mr. Gorman that the Commission should impose a five year rate freeze on PGL and North Shore as a condition of merger approval?

A. No, I do not. The standard in Illinois is not that the proposed reorganization should provide benefits to customers comparable to the value enhancement created by regulatory mechanisms, as Mr. Gorman states on page 2, lines 24-26, of his direct testimony. Rather, the merger standard is that the proposed reorganization should not diminish service quality (Section 7-204(b)(1)), result in unjustified subsidization of non-utility activities by the utility or its customers (Section 7-204(b)(2)), significantly impair the utility's ability to access capital on reasonable terms (Section 7-204(b)(4)), have a significant adverse effect on competition (Section 7-204(b)(5)), or be likely to have any adverse rate impact on retail customers (Section 7-204(b)(7)).

Mr. Gorman has established no link between the risk reduction provided by regulatory mechanisms and riders and the value enhancement that he believes will occur as a result of the proposed reorganization. Rider QIP, for example, is designed to offset the incremental risk associated with the AMRP at PGL; it does not reduce the Gas Companies' cost of capital below industry norms. The same is true with other riders and cost tracking mechanisms.

Further, all of these regulatory mechanisms and riders were already in place before the merger was announced, so it is not reasonable to suggest that the presence of

[26] Ibid, at 6.

[27] Ibid, at 10.

these regulatory mechanisms and riders made Integrys more valuable to an acquiring company (WEC) than to its own shareholders. Investors were already aware of the rider mechanisms at PGL and North Shore before the merger, and the valuation of the parent holding company (Integrys) reflected that information. Further, Mr. Gorman tries to link the regulatory mechanisms and riders to the premium that WEC agreed to pay for Integrys' stock. However, he offers no basis for that view; and the Joint Applicants have indicated that they do not intend to seek recovery of the acquisition premium.

In summary, Mr. Gorman's testimony in support of a five year rate freeze is not persuasive. Mr. Gorman has provided no evidence that the proposed reorganization would fail to satisfy the Illinois merger requirements, including maintaining service quality at current levels, maintaining access to capital on reasonable terms, and not having an adverse rate impact on retail customers.

Q. What is Mr. Gorman's position with respect to the recovery of transition costs?

A. Mr. Gorman testifies that "[n]o costs associated with WEC's proposed acquisition/merger with Integrys ("Transaction") or the reorganization integration should be subject to recovery from retail customers in the ratemaking process as a condition of the merger."[28] In particular, Mr. Gorman recommends that the Joint Applicants should not be allowed to recover the cost of severance packages or early termination fees for executives or employees, as well as the costs of integrating the operations of the two companies, including costs of restructuring corporate divisions, relocating personnel or operations, and installing the same accounting and IT systems for all units.[29]

[28] Ibid, at 2.

[29] Ibid, at 11-12.

Q. Please explain the difference between transaction costs and transition costs.

A. Transaction costs are costs associated with executing the transaction such as banker's fees, legal fees, etc. Transition costs are costs incurred to achieve long-term efficiencies and savings.

Q. Why do you believe it is appropriate for WEC to recover transition costs?

A. WEC has agreed that it will not seek recovery of transaction costs, including any severance package costs (*i.e.*, executive change-in-control payments as identified in an SEC Form S-4) that have been classified as transaction costs. However, future severance package costs which may be incurred to create efficiencies and savings would be properly classified as transition costs for which WEC may seek recovery. The same is true of other transition costs that are incurred during the merger integration process and which may ultimately lead to savings, such as corporate restructuring costs, relocation costs, and accounting and IT integration costs. Using severance costs as an example, Mr. Gorman's position is that the Commission should accept lower salary costs in rates, but should not allow recovery of severance costs that are incurred to achieve those lower salary costs. This is not just and reasonable, cost-based ratemaking.

WEC has committed that recovery of transition costs will be limited to those costs that do not exceed the savings produced. Future rates will reflect any savings that are achieved through these transition costs, so allowing the netting of these costs is reasonable and benefits customers.

Q. Why does Mr. Gorman recommend that the Commission impose ring fencing requirements for PGL and North Shore as a condition of approving the proposed reorganization.

A. Mr. Gorman believes that there is a risk that WEC's consolidated cash flow will not be realized as projected, and that acquisition-related debt will create financial distress at WEC and compel WEC to withdraw more cash from its utility affiliates to satisfy its financial obligations.[30] Mr. Gorman also argues that if PGL and North Shore are required to pay more dividends to WEC to finance debt payments this will reduce the cash flows available for system modernization and could delay replacement of aging infrastructure or require more external debt financing.[31] In addition, Mr. Gorman states that pressure from the parent company (WEC Energy Group) to maintain cash flow to cover acquisition-related debt could affect PGL's AMRP.[32] He contends that the Wisconsin PSC's protection of ratepayers and service quality will result in pressure to increase the amount of cash withdrawn from non-Wisconsin utilities.[33] On this basis, Mr. Gorman recommends that WEC should make a commitment and adopt ring fencing restrictions that limit its ability to require PGL and North Shore to make dividend payments or any other cash transfer to WEC before PGL's and North Shore's capital investment requirements, including AMRP, are fully funded.[34]

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30 Ibid, at 13.

31 Ibid, at 15.

32 Ibid, at 17.

33 Ibid, at 18.

34 Ibid, at 22.

Q. What is your response to Mr. Gorman's ring fencing recommendation?

A. As a preliminary matter, Mr. Gorman's recommendation is not clear. On page 2 of his direct testimony, Mr. Gorman states that PGL and North Shore should be required to fund their capital investment programs "before dividends are increased", while on page 22, Mr. Gorman indicates that WEC should commit to ring fencing restrictions that limit its ability to require PGL and North Shore to "make dividend payments or any other cash transfer to WEC" before the Gas Companies' capital investment programs are fully funded.

Notwithstanding the exact conditions upon which Mr. Gorman's ring fencing recommendation depends, his underlying logic assumes that negative free cash flows cause a company to avoid making investments rather than going to capital markets for additional funding. This is simply not true. As long as a utility has a reasonable opportunity to earn an adequate return, it will continue to invest in rate base. In the case of PGL's AMRP, the Commission has approved a legislatively-authorized cost tracker (i.e., Rider QIP) to offset the incremental risk of making the capital investment.

Mr. Gorman has provided no evidence that the proposed reorganization will reduce WEC's ability to raise capital on reasonable terms to fund its capital spending requirements. Additionally, Mr. Gorman's concern about whether acquisition-related debt will affect WEC's cash flows is not shared by S&P. As noted by Mr. McNally, S&P does not expect the additional debt used to finance the merger will result in WEC's inability to maintain credit metrics required to support the current credit rating. On that basis, Mr. McNally agrees that the proposed reorganization will not impair the Gas Companies' ability to raise capital on reasonable terms.

As Mr. Gorman notes, WEC has provided detailed cash flow projections that outline its ability to support the acquisition-related debt along with its other financial obligations after the transaction is completed.[35] In addition, WEC indicated in a November 2014 investor presentation that it expects to be cash flow positive on an annual basis after the Transaction closes.[36] Mr. Gorman has prepared CUB Exhibit 4.1 based, in large part, on WEC's cash flow projections that were provided to the Credit Rating Agencies in order to assess the credit metric impact of the Transaction before it was completed. As shown on CUB Exhibit 4.1, Mr. Gorman's cash flow analysis assumes that WEC will be paying the full amount of principle and interest on the acquisition related debt in 2015; however, this is not reasonable since the Transaction is not expected to close until the middle of 2015. Furthermore, Mr. Gorman's cash flow analysis assumes that the acquisition-related debt will be financed through an amortizing loan over 15 years, and that debt service will include both principle and interest. My understanding, however, is that WEC plans to go to the capital markets to fund the acquisition-related debt. Consequently, Mr. Gorman's calculation of debt service payments on CUB Exhibit 4.1 does not appear to reflect the actual cash flows that WEC will make on the acquisition-related debt from 2015-2018.

Finally, WEC has committed to continue PGL's AMRP. As stated throughout my direct and rebuttal testimony, I believe that the proposed reorganization will enhance the ability of WEC Energy Group to finance the capital investment requirements of its operating utilities, including PGL and North Shore. Mr. Gorman has provided no persuasive evidence that the Gas Companies will be unable or unwilling to continue

[35] Direct Testimony of Michael P. Gorman, at 14.

[36] WEC Investor Presentation, November 1, 2014, at 20.

making the necessary investments in their gas distribution systems unless the Commission imposes ring fencing requirements as a condition of merger approval.

V. CONCLUSIONS AND RECOMMENDATIONS

Q. Please summarize your conclusions and recommendations.

A. Nothing in the testimonies of Messrs. McNally, Lounsberry, or Gorman causes me to change my view that the proposed reorganization (1) meets the statutory requirements in Illinois, (2) satisfies the Commission's standard of review, and (3) should be approved by the Commission.

The proposed reorganization will neither diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, nor is it likely to result in any adverse rate impacts on retail customers, which are the statutory requirements questioned by Mr. Lounsberry and Mr. McNally. Mr. McNally has concluded that the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure. That, coupled with the enhanced financial strength of WEC Energy Group and its ability to potentially finance capital expenditures through internal financing rather than going to external capital markets, will enhance PGL's and North Shore's ability to provide safe, adequate, reliable, efficient, least-cost public utility service, and may in fact lead to a reduction in the Gas Companies' cost of debt. All of this, taken with (1) the fact that WEC Energy Group will have virtually no non-utility affiliates (the most significant source of incremental risk to the cost of capital), (2) credit rating agency comments that it is unlikely that WEC will be downgraded due to the acquisition, (3) WEC's commitment for a two-year base rate freeze at PGL and North Shore after the Transaction closes, and

(4) the Commission's ability to address base rates thereafter, more than satisfy the statutory requirements questioned by Messrs. McNally and Lounsberry.

There is no need to impose a five-year rate freeze on the Gas Companies or the ring fencing requirements proposed by Mr. Gorman in order for this transaction to meet the Commission's standard for approval. In addition, the Commission should allow recovery of transition costs, including severance costs and merger integration costs such as corporate restructuring costs, relocation costs, and accounting and IT-related integration costs, to the extent those transition costs are incurred to achieve savings after the merger is completed. Finally, in my view, the Joint Applicants have completed the customary due diligence process for this type of transaction.

I continue to believe that the proposed reorganization will result in long-term benefits for Illinois ratepayers, as well as for shareholders of both WEC and Integrys. As such, I recommend that the Commission approve the reorganization as proposed by the Joint Applicants.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.